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National is People

NATIONAL TEA CO.

ANNUAL REPORT 1961

National is People

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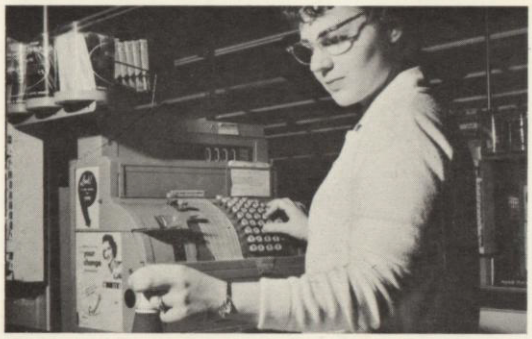

National is People

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Directors

Norbert L. Chaplicki
Vice President

John F. Cuneo*
President of the Cuneo Press, Inc.

Edward L. Jones
Secretary of George Weston, Limited

Harley V. McNamara*
Chairman of the Executive Committee

Richard G. Meech
Vice President, Secretary and Treasurer of Loblaw Groceterias Co., Ltd.

George C. Metcalf*
Chairman of the Company and President of Loblaw Groceterias, Co., Ltd.

Norman A. Stepelton
President and Chief Executive Officer

Claude H. Webster
Executive Vice President

W. Garfield Weston
Chairman of the Board of George Weston, Ltd.

**Members of the Executive Committee*

Officers

George C. Metcalf
Chairman of the Company

Harley V. McNamara
Chairman of the Executive Committee

Norman A. Stepelton
President and Chief Executive Officer

Claude H. Webster
Executive Vice President

Norbert L. Chaplicki
Vice President

George E. Houston
Vice President

Harold L. Wilkens
Vice President

E. Guy Loy
Vice President

Henry Niemann
Vice President

William T. Morgan, Jr.
Vice President and Secretary

Charles Wooding
Treasurer

Robert E. Koehler
Comptroller and Asst. Treasurer

Transfer Agents

The First National Bank of Chicago
Chicago, Illinois

The Chase Manhattan Bank
New York, New York

Registrars

Continental Illinois National Bank & Trust Company of Chicago
Chicago, Illinois

Chemical Bank New York Trust Company
New York, New York

Trustees and Paying Agents

3½% Debentures
Chemical Bank New York Trust Company
New York, New York

5% Debentures
Morgan Guaranty Trust Company
New York, New York

NATIONAL TEA CO.

HOME OFFICE:
1000 N. CROSBY STREET
CHICAGO 10, ILLINOIS

National Branch Offices and Warehouses • CHICAGO • MINNEAPOLIS • MILWAUKEE • INDIANAPOLIS • DETROIT • ST. LOUIS • NEW ORLEANS • MEMPHIS • DAVENPORT • DENVER • SIOUX CITY

National Food Stores Serving The States of • ALABAMA • ARKANSAS • COLORADO • ILLINOIS • INDIANA • IOWA • LOUISIANA • MICHIGAN • MINNESOTA • MISSISSIPPI • MISSOURI • NEBRASKA • NORTH DAKOTA • OHIO • SOUTH DAKOTA • TENNESSEE • WISCONSIN • WYOMING

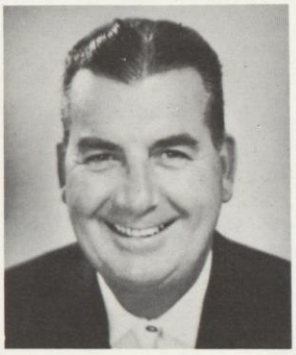
National is People

Financial Highlights

	1961	1960
Operations		
Sales	$888,852,905	$855,840,888
Income before income taxes	19,464,514	17,861,825
Federal income taxes	10,150,000	9,200,000
Net income	9,314,514	8,661,825
—Percent to sales	1.05%	1.01%
—Percent to beginning shareholders' equity	11.34%	10.99%
Cash dividends	5,674,664	5,637,287
Earnings retained in the business	3,639,850	3,024,538
Investment		
Working capital	42,422,922	43,376,122
Property and equipment	76,703,420	71,579,665
Long-term debt	29,628,922	31,104,000
Common shareholders' equity	87,039,714	82,140,961
Shares outstanding	7,133,505	7,053,722
Per Common Share		
Income (based on average shares outstanding)	1.31	1.23
Dividends	.80	.80
Shareholders' Equity	12.20	11.65
Total Stores		
—at end of year	897	897

To The Stockholders and Employees of National Tea Co.

HARLEY V. McNAMARA
Chairman of the Executive Committee



NORMAN A. STEPELTON
President and Chief Executive Officer

Your management is particularly pleased to present this 1961 Annual Report.

Despite a year fraught with factors combating normal profits . . . ever increasing and more intensive competition, strike losses and tardiness of general economic recovery . . . National experienced substantial growth.

Sales and profits climbed to an all time high. Total sales topped 888 million, a gain of nearly 4% over 1960...and net profits climbed to almost 9½ million, an increase of 7.5% over last year.

We do not, however, plan to rest on our laurels. As in the past, your Company will press forward with vigorous expansion. New stores, remodeling, and continued experimentation with food discount units are all part of our future plans.

We recognize too, that our present growth, and our future is predicated on the performance of the 25,000 employees and the support of the 17,000 shareholders who are National. Using 1961 as a yardstick of the hard work and devotion of these people . . . our future is indeed bright.

This 1961 Annual Report will tell you how effectively the people who are National have done their jobs. That's why its theme is: *National Is People.*

H V McNamara — *Chairman of the Executive Committee*

N. A. Stepelton — *President*

CLAUDE H. WEBSTER
Executive Vice President

E. GUY LOY
Vice President

NORBERT L. CHAPLICKI
Vice President

WILLIAM T. MORGAN, JR.
Vice Pres. and Secretary

GEORGE E. HOUSTON
Vice President

ROBERT E. KOEHLER
Comptroller and
Assistant Treasurer

HAROLD L. WILKENS
Vice President

HENRY H. NIEMANN
Vice President

A Special Note from The President

On April 1 of this year, I will have completed my first year as your President. It seems to me that this is a most opportune time to express my sincere appreciation to a number of very wonderful people, whose kind assistance and guidance has been indispensable.

First of all, I want to thank Mr. H. V. McNamara, our former President and now Chairman of the Executive Committee. Mr. Mac's constant inspiration and counsel have been invaluable.

Next, I would like to express my gratitude to all my associates here in the home office and to the Division Managers and their executive staffs in all Divisions.

Most of all, my appreciation must go out to the 25,000 men and women in the stores, offices and warehouses, who have truly been responsible for our successful year.

Thanks to all of you—the people who are National—for making my first year such a pleasant one.

N. A. Stepelton — *President*

About Sales and Profits

As was indicated in the President's letter, both gross sales and net profits of the Company are at an all time high. As a consequence of this, the individual stockholder's equity is also the highest it has ever been.

New sales records were established for the 23rd consecutive year, in spite of lower prices for meat and produce. 1961 sales of $888,852,905 were $33,012,017 or 3.86% over 1960's record. Average sales per store were $990,917 for the year, equivalent to $19,056 per week as compared with $18,216 per week in 1960. Next year, sales will top $1,000,000 per store.

Division Managers and their organizations are basically responsible for the excellent results. While sales have been increased, the ascending spiral of expenses has been held in good control.

Despite intense competition from various sources, the Division Organizations have worked in close cooperation with the various departments of the Company to meet the challenge . . . and they surmounted the obstacles. For example, the Minneapolis Division profits were hampered by a major strike in the Spring of 1961.

Net income reached a new high in 1961—continuing a record achieved in 9 out of the last 11 years. 1961 profits of $9,314,514 were $652,689 or 7.5% ahead of 1960. This is $1.31 per average share outstanding as compared with $1.23 per share in 1960.

Additional efforts to improve profits, through efficient operations, will be continued. For example, the consolidation of the Kalamazoo unit with the Detroit Division in 1961 resulted in greater over-all efficiency, reduced overhead and generally benefited the Company.

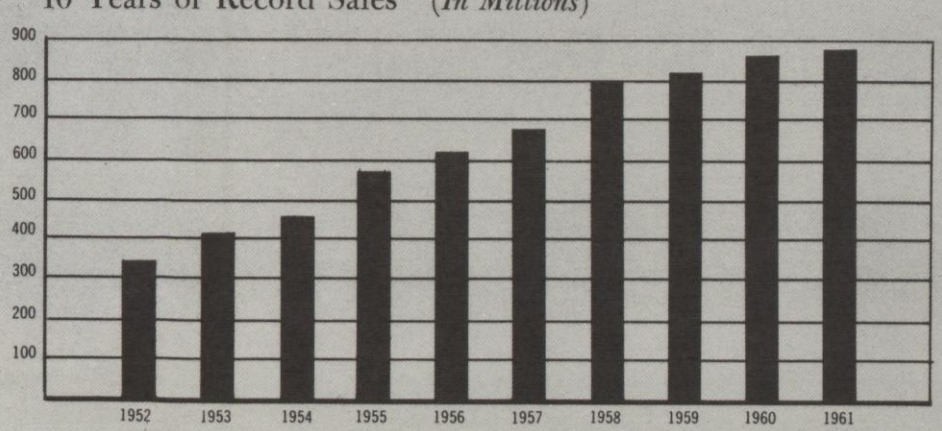
About Competition

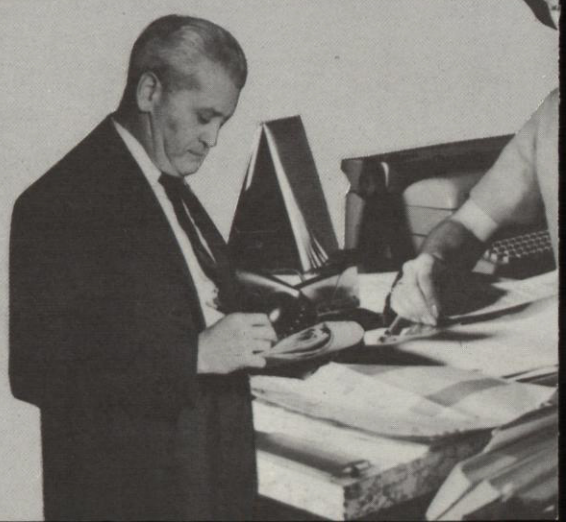
It is common place today to have financial reports speak of competition as, "being greater than ever before." In actual fact, grocery retailing has been undergoing drastic evolutionary changes during the past few years. The changes might be described as from Supermarkets to still larger Supermarkets . . . from Supermarkets to Shopping Centers . . . and now to discount stores.

Hundreds of Shopping Centers have been spreading out into mushrooming suburbia. Populations have been moving to the periphery of the larger cities and the shopping habits of the people have moved accordingly. National Food Stores have been in the midst of this tumultuous marketing gyration.

For a number of years now, your Company has been experimenting with a number of different types of Supermarkets in various locales. The so-called discount store, or as we prefer to call it, the food discount store, has actually been pioneered by your Company. Testing in this field will continue . . . so that we may determine whether sufficient profit is obtainable before committing ourselves on a larger scale.

10 Years of Record Sales *(In Millions)*





National is People

It is National's policy to continue experimenting with the newest ideas in retailing. However, always with an eye toward profitable results.

About National's people

Employee morale is the most important asset of our Company, and is exemplified by the theme of this Report, "National Is People."

Two factors which the Company has employed to keep morale high are:

A. Promoting from the ranks·

B. Profit Sharing

Plus, of course, a warm, friendly employee-employer relationship.

During 1961, more than 1,400 people, including store managers and other key personnel, participated in the Company's Profit Sharing Program. This plan is helping the Company maintain and select the very finest personnel.

About expansion

The Company will continue with its program of replacing outmoded and obsolete stores. It will continue its plan of moving with the shifting population, discontinuing locations that have become less favorable. It will continue to seek out most promising areas for new locations, new development, and for new opportunity. Approximately 60 new stores are planned for 1962.

In December of this past year, National purchased the Sure Save Stores comprising eleven stores in Chicago and its suburbs. These units are located in areas where National does not have stores. The Company feels most fortunate, indeed, to have been able to retain Mr. George Kokalis as Vice President and General Manager of the Sure Save Division.

Also, in connection with the Company's expansion, a new modern warehouse is being completed in the New Orleans Division. It is expected to be in operation before the end of 1962. This warehouse will be of the very latest design, containing approximately 270,000 square feet, and will serve stores located in Louisiana, Mississippi and Alabama.

About Executive Changes

In the Spring of 1961, Mr. Henry Niemann, who had been doing an outstanding job as head of the Milwaukee Division, was promoted. He was made Vice President and General Manager of the Chicago Division.

Mr. J. Ed Laughlin, formerly in charge of the Sioux City Division was given the responsibility of directing the Milwaukee Division.

Mr. Don O'Neil, formerly Sales Manager of Sioux City, was named that Division's Manager.

The Company is delighted to announce these major promotions of top executives. All of them are men who have moved up within the Company. This gives further emphasis to the Company's slogan, "National Is People."

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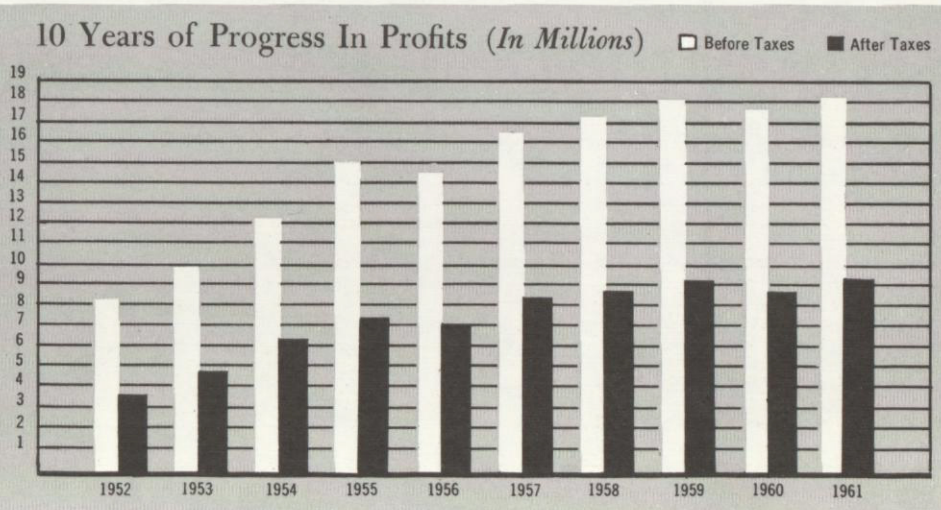
10 Years of Progress In Profits (*In Millions*)



1961 Distribution of the Sales Dollar

79.93 Cost of Merchandise Sold

11.61 Wages & Benefits

3.32 Rents, Repairs & Depreciation

About Dividends and Shareholders' Equity

Cash dividends of 80¢ per share were paid in 1961, continuing at the rate of 20¢ each quarter as established in June, 1959.

Shareholders' equity rose $4,898,753 in 1961 to $87,039,714 or $12.20 per common share outstanding. The number of shareholders continues to rise, and is now estimated to be about 17,000. There were 29,593 common shares issued in 1961 in conversion of 3½% debentures and 339,378 unissued shares are reserved for possible future conversions. This represents a potential dilution of less than 5%.

About Finances

All of the net income not paid out in dividends is reinvested in plant and equipment. In 1961, we opened 53 new stores and acquired 13 others, but we closed 66 old stores so there was no net change for the year. However, the net investment in fixed assets increased $5,123,755 because of the greater investment in larger, better equipped stores.

Inventory requirements to stock these new, larger stores also are greater, accounting for much of the $5,260,128 rise in merchandise inventories reported in the balance sheet.

Net working capital was reduced $953,200 in 1961 and has reached the point where consideration must be given to the need for additional long-term borrowings to provide replenishment and also to finance the new warehouse in New Orleans which is now under construction. Following is a comparative summary of the source and disposition of working capital for 1961 and 1960:

	1961	1960
Source of Funds:		
Net income	$9,314,514	$8,661,825
Less dividends paid	5,674,664	5,637,287
Net earnings retained	$3,639,850	$3,024,538
Deferred Federal income tax on accelerated depreciation	707,000	897,000
Sale of common shares to optionees	395,890	169,788
Mortgage loans on store buildings	374,485	200,000
Treasury shares applied to acquisition of businesses	440,120	410,536
Other sources, net	745,306	190,689
	$6,302,651	$4,892,551
Disposition of Funds:		
Net expenditure for plant and equipment in excess of depreciation and amortization	$3,782,322	$3,529,778
Acquisitions of other businesses	2,165,966	775,500
Retirement of long-term debt	1,307,563	1,166,000
	$7,255,851	$5,471,278
Decrease in Working Capital	$ 953,200	$ 578,727

2.41 Other Expense

1.68 Taxes

.64 Dividends

.41 Retained Profit

Ten Year Review of Financial Highlights

Continued Progress Report 1952-1961

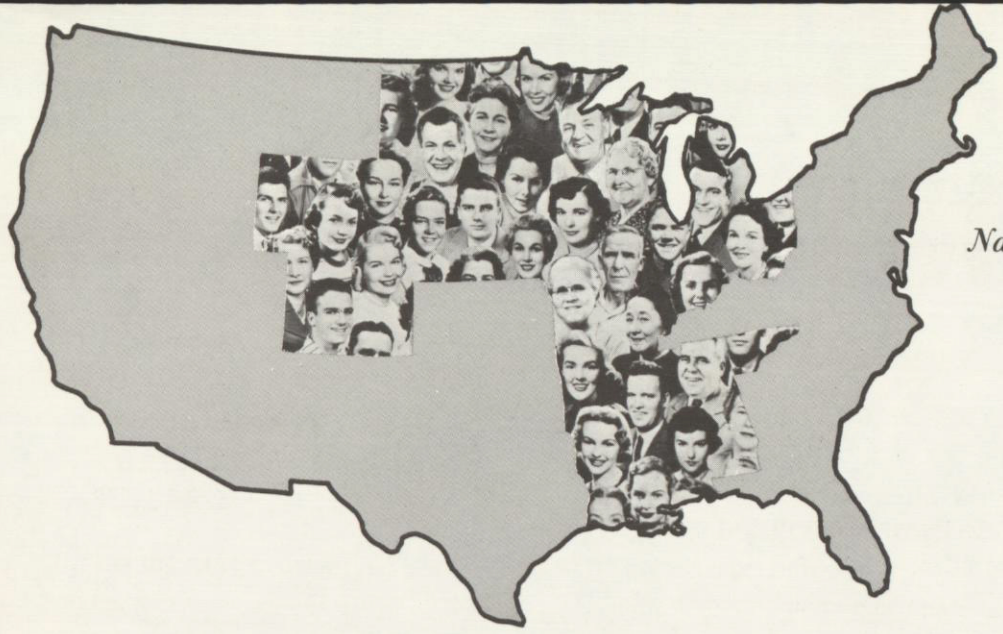
Year	61	60	59	58 53 WEEKS	57	56	55	54	53	52
										Following reported in thousands (000 omitted)
Operations										
Sales	$888,853	$855,841	$829,518	$794,162	$681,132	$617,636	$575,585	$520,300	$462,282	$405,220
Income Before Federal Taxes	19,465	17,862	18,145	17,742	16,774	14,938	15,237	12,739	10,048	8,408
Federal Income Taxes	10,150	9,200	9,120	8,900	8,720	7,930	8,000	6,220	5,150	4,690
Net Income	9,315	8,662	9,025	8,842	8,054	7,008	7,237	6,519	4,898	3,718
Percent to Sales	1.05%	1.01%	1.09%	1.11%	1.18%	1.13%	1.26%	1.25%	1.06%	.92%
Percent to Beginning Common Shareholders' Equity	11.34%	10.99%	13.11%	14.31%	14.31%	13.10%	15.75%	17.75%	14.71%	11.12%
Cash Dividends:										
Preference	—	—	—	—	—	—	1	212	450	504
Common	5,675	5,637	5,266	4,372	4,293	4,241	4,198	2,961	2,594	2,498
Earnings Retained Before Special Items	3,640	3,025	3,759	4,470	3,761	2,767	3,038	3,346	1,854	716
										Following reported in thousands (000 omitted)
Investment										
Working capital	42,423 (1)	43,376 (1)	43,955 (1)	46,446 (1)	51,039 (1)	42,633	44,122	34,118	30,002	22,586
Property and equipment	76,703	71,580	67,276	62,598	53,834	43,143	38,530	29,499	25,457	19,413
Long-term debt	29,629	31,104	32,070	39,485	42,539	30,103	30,700	16,200	16,200	4,200
Common shareholders' equity	87,040	82,141	78,847	68,859	61,801	56,286	53,499	45,929	35,538	30,239
Shares outstanding	7,134 (2)	7,054 (2)	7,034 (2)	2,221	2,167	2,121	2,120	1,971	1,707	1,568
										(1958 and prior years adjusted for 3 for 1 split on March 26, 1959)
Per Common Share										
Income (based on avg. shares outstanding)	1.31	1.23	1.32	1.34	1.25	1.10	1.18	1.14	.91	.69
Dividends	.80	.80	.77	.67	.67	.67	.67	.53 (3)	.53	.53
Equity	12.20	11.65	11.21	10.33	9.51	8.85	8.41	7.77	6.94	6.43
Total Stores										
At year end	897	897	910	932	883	761	744	711	688	765

(1) Prepaid expenses included in working capital since 1957.
(2) $4 par value shares after 3 for 1 split on March 26, 1959.
(3) Plus extra 2% stock dividend paid to shareholders of record on November 16, 1954.

National is People

1961 Consolidated Balance Sheet

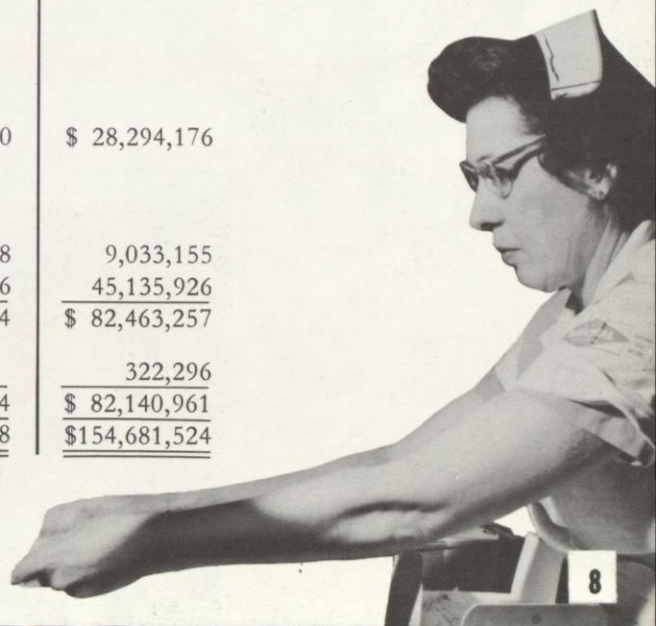
Assets	Dec. 30, 1961	Dec. 31, 1960
Current Assets:		
Cash	$ 14,731,596	$ 15,688,024
Accounts receivable	5,105,609	4,130,264
Inventories, at lower of cost or market—		
Merchandise	62,591,819	57,331,691
Supplies	1,769,454	1,674,956
Prepaid expenses	2,393,870	2,017,750
Land in process of development and sale	711,436	—
Total current assets	$ 87,303,784	$ 80,842,685
Other Assets	$ 2,219,294	$ 2,259,174
Property and Equipment, at cost, less reserves for depreciation		
Land	$ 2,182,674	$ 1,977,078
Buildings	9,642,025	10,197,964
Fixtures and equipment	82,844,192	76,664,772
Reserves for depreciation	(37,493,015)	(35,463,823)
Leasehold improvements, less amortization	18,598,752	17,030,967
	$ 75,774,628	$ 70,406,958
Excess of cost of investment in branches and subsidiaries over underlying book values at dates of acquisition—in process of amortization	928,792	1,172,707
	$ 76,703,420	$ 71,579,665
	$166,226,498	$154,681,524



National Tea Co. & Subsidiaries

Liabilities

	Dec. 30, 1961	Dec. 31, 1960
Current Liabilities:		
Notes payable	$ 4,000,000	$ 2,000,000
Current maturity of long-term debt	1,266,000	1,166,000
Accounts payable	26,349,395	22,150,771
Accrued liabilities	6,968,437	6,736,094
Federal income taxes	6,297,030	5,413,698
Total current liabilities	$ 44,880,862	$ 37,466,563
Long-Term Debt:		
Mortgage notes on store buildings	$ 532,922	$ 200,000
3½% promissory notes, due 1969	602,000	688,000
4% promissory notes, due 1973	12,200,000	12,900,000
5% sinking fund debentures, due 1977	10,080,000	10,560,000
3½% subordinated debentures, due 1980 (convertible into common shares through 1965)	6,214,000	6,756,000
	$29,628,922	$31,104,000
Reserves:		
Deferred Federal income taxes (relating to accelerated depreciation)	$ 4,427,000	$ 3,720,000
Self-insurance	250,000	250,000
	$ 4,677,000	$ 3,970,000
Capital Stock and Surplus:		
Common shares ($4 par value)		
	1961 / 1960	
Authorized	10,000,000 / 10,000,000	
Issued	7,133,505 / 7,073,544	$ 28,534,020 / $ 28,294,176
Reserved for options and conversions	497,363 / 560,212	
Paid-in surplus	9,729,918	9,033,155
Earned surplus	48,775,776	45,135,926
	$ 87,039,714	$ 82,463,257
Less—Cost of treasury common shares—1960—19,822 shares	—	322,296
	$ 87,039,714	$ 82,140,961
See notes to financial statements.	$166,226,498	$154,681,524



National is People

Statements of Consolidated Income and Surplus

National Tea Co .& Subsidiaries

Income

	52 weeks 1961	52 weeks 1960
SALES	$888,852,905	$855,840,888
COSTS AND EXPENSES		
Cost of sales and expenses	$842,991,880	$812,713,654
Depreciation and amortization	9,707,557	9,153,589
Rent	14,708,367	14,067,887
Interest	1,481,587	1,585,933
Profit sharing	499,000	458,000
Federal income taxes	10,150,000	9,200,000
	$879,538,391	$847,179,063
NET INCOME	$ 9,314,514	$ 8,661,825

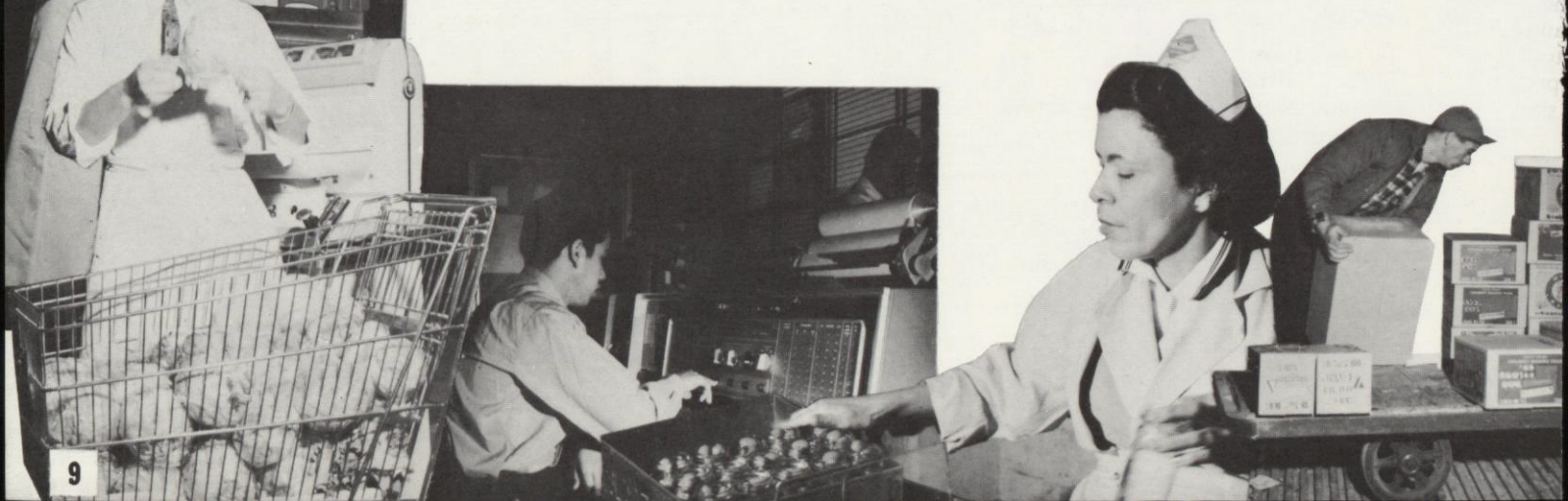
Earned Surplus

BALANCE AT DECEMBER 31, 1960	$ 45,135,926
NET INCOME	9,314,514
	$ 54,450,440
DIVIDENDS paid on common shares ($.80 per share)	5,674,664
BALANCE AT DECEMBER 30, 1961	$ 48,775,776

Paid-In Surplus

BALANCE AT DECEMBER 31, 1960	$ 9,033,155
ADD	
Excess of principal amount of debentures retired over par value of common shares issued in conversion	422,345
Excess of proceeds over par value of common shares sold to officers and employees under stock option plans	274,418
BALANCE AT DECEMBER 30, 1961	$ 9,729,918

See notes to financial statements.



Notes to Financial Statements—December 30, 1961

Long-Term Debt

The 3½% promissory notes require annual prepayments of $86,000 through 1968.

The 4% promissory notes require annual prepayments of $700,000 in 1962 through 1964 and $1,000,000 in 1965 through 1972.

The 5% sinking fund debentures require mandatory sinking fund payments sufficient to retire $480,000 debentures in each of the years 1962 through 1972 and $600,000 of debentures in each of the years 1973 through 1976.

Annual sinking fund requirements to maturity of the 3½% subordinated debentures have been satisfied by conversions into common shares. The remaining debentures are convertible into common shares at $18.31 per share through November 1, 1962 and $19.15 per share through November 1, 1965.

Aggregate maturities and sinking fund requirements under long-term debt, exclusive of minor installments due on mortgage loans on store buildings, are $1,266,000 for 1962, 1963 and 1964 and $1,566,000 for 1965 and 1966.

Dividend Restriction

Under the terms of the long term debt agreements earned surplus of $25,121,018 is restricted as to the payment of cash dividends on and the purchase of common shares at December 30, 1961, subject to the maintenance of $25,000,000 of working capital and a current ratio, as defined in the agreements, of at least 2 to 1.

Stock Options

As of December 30, 1961 there were 157,985 unissued common shares reserved for employee stock options under the plans approved by shareholders in 1957 and 1959. Each option expires five years after grant but not later than January 1, 1966 for the 1957 Plan and January 1, 1969 for the 1959 Plan. 20% of the shares covered by each option becomes exercisable ten months after grant of the option and an additional 20% becomes exercisable each year thereafter.

At December 30, 1961 options for 128,235 shares were outstanding at prices ranging from $11.92 to $21.02 per share, of which 43,923 shares were exercisable.

F.T.C. Complaint

In March, 1959, the Federal Trade Commission filed a complaint against the company alleging that several acquisitions of additional retail grocery stores violated Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. There has been no indication from the preliminary hearings that there should be any adverse effect on the company as a result of the complaint.

Lease Commitments

At December 30, 1961 the company and its subsidiaries had 764 leases expiring more than three years after that date (some of which contain percentage rental clauses) with minimum annual rentals amounting to approximately $14,085,000 exclusive of taxes, insurance and maintenance payable by the lessee. Of this amount, approximately 70% applies to leases expiring within 10 years.

ARTHUR ANDERSEN & CO.

120 South La Salle Street
Chicago 3

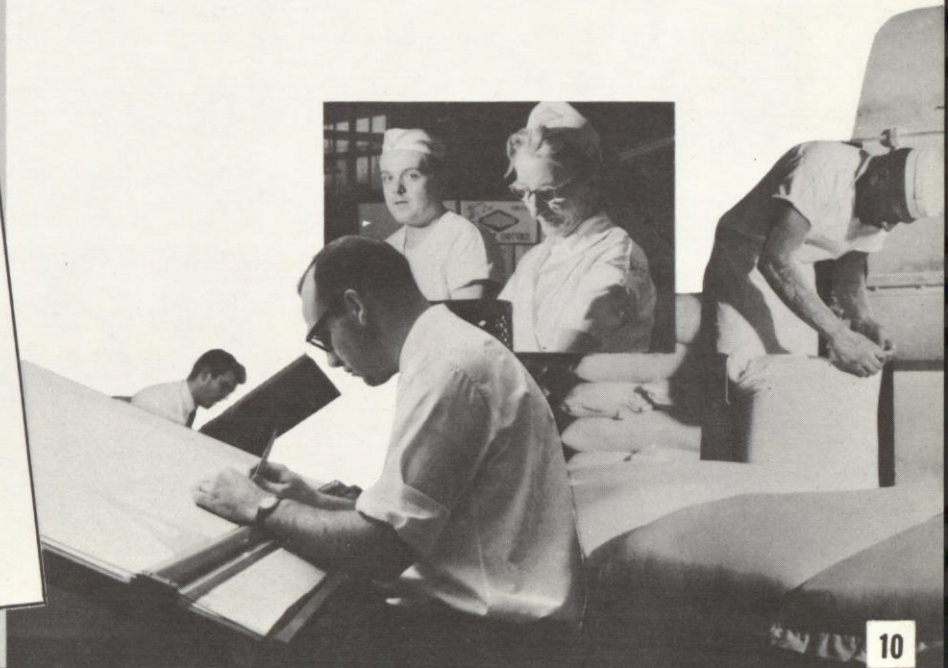
the Shareholders,
ational Tea Co.:

We have examined the consolidated balance sheet NATIONAL TEA CO. (an Illinois corporation) ND SUBSIDIARIES as of December 30, 1961 and he related statements of consolidated income and surlus for the fifty-two weeks then ended. Our examinaion was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and statements of consolidated income and surplus present fairly the financial position of National Tea Co. and Subsidiaries as of December 30, 1961 and the results of their operations for the fifty-two weeks then ended, and were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fifty-two week period.

ARTHUR ANDERSEN & CO.

Chicago, Illinois
February 9, 1962



National is People

25,000 people serving 4,500,000 customers every day, in 897 local National Food Stores!

In just 10 years the average National Store has grown from 1000 to 5000 customers; from 3,750 merchandise items to over 6,000; from 10 display areas to 35; from 7 employees to 25!

This tremendous growth has focused the importance on the local store unit and its operation. Only the local store team can achieve a successful operation in the increased competitive field where expenses represent such an important factor in the operations.

Today's National Food Store Manager is more than a merchandiser; he is also an administrator and an executive. But, while he bears the direct responsibility of his store's operation, his achievement is assured only by his team . . . the people in his own store, the people at the division and national level serving his operation.

They are the division baker, the packer, the truck driver and warehouse man; the market manager, checker, buyer and office worker; the stock boy, the produce manager, the carry-out boy, the trainee. And in a special way, the quality control man.

Their services, though seemingly varied, add up to one impression in the customer's mind: "*National means quality!*" Quality in product, quality in service, quality in the feeling of friendship that's so hard to define.

To this dedicated team of 25,000 people who are National goes the credit for a reputation that spreads even beyond its nearly-national bounds. It's their teamwork and achievement which make this 1961 Annual Report of National Tea Co. such a pleasure for workers, friends and investors to read.

These People are National...

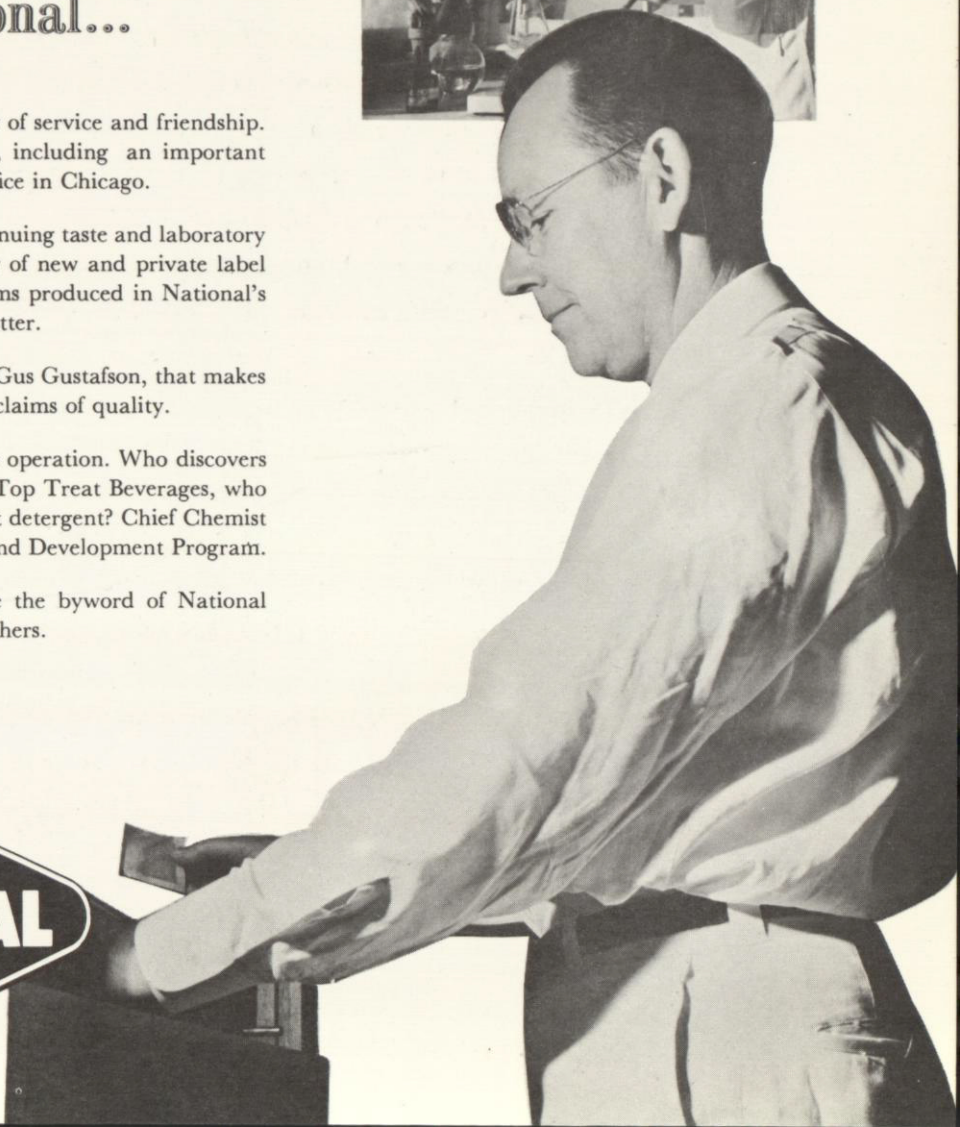
The many people who are National guard its quality of service and friendship. An important handful guard its quality of product, including an important staff of quality control experts at National's home office in Chicago.

There, a team of five skilled technicians conduct continuing taste and laboratory tests, guarding standards of color, flavor and quality of new and private label products; checking every single ingredient of the items produced in National's own food processing plant, from pickles to peanut butter.

It is National Quality Control, under Chief Chemist Gus Gustafson, that makes sure every product in every National store meets its claims of quality.

Continuous testing is but the beginning of this staff's operation. Who discovers how to ideally carbonate a proposed new flavor for Top Treat Beverages, who develops an improved gelatin dessert, a more efficient detergent? Chief Chemist Gustafson in Quality Control's important Research and Development Program.

"The best today, better tomorrow," might well be the byword of National Quality Control, who *insure* the growth assured by others.



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